(13)

No. 92-854

In the Supreme Court of the United States

OCTOBER TERM, 1993

CENTRAL BANK OF DENVER, N.A., PETITIONER

v.

FIRST INTERSTATE BANK OF DENVER, N.A., AND JACK K. NABER

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

DREW S. DAYS, III
Solicitor General

EDWIN S. KNEEDLER
Deputy Solicitor General

EDWARD C. DUMONT
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

BRIAN D. BELLARDO
Assistant General Counsel

BRIAN F. MCNALLY
Senior Litigation Counsel

DIANE WHITE
WILLIAM JOHNSON
Attorneys
Securities and Exchange Commission
Washington D.C. 20549

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QUESTIONS PRESENTED

1. Whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and the Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. 240.10b-5.

2. Whether recklessness, as opposed to conscious intent, is sufficient to satisfy the scienter element of aiding-and-abetting liability under Section 10(b) of the Securities Exchange Act, where the defendant's substantial assistance of the primary wrongdoing consists of affirmative action rather than silence and inaction.

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INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission administers and enforces the federal securities laws. The questions presented in this case are whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and the Commission's Rule 10b-5, 17 C.F.R. 240.10b-5, and, if so, whether recklessness satisfies the scienter element for such liability in the circumstances of this case. Private actions under Rule 10b-5 are an essential supplement to Commission enforcement of the Exchange Act, and the Commission has a strong interest in

seeing that the principles applied in such actions promote the purposes of the securities laws. Aiding-and-abetting liability and the recklessness standard are also critical in the Commission's own enforcement actions. The United States filed a brief in this case at the petition stage at the invitation of the Court.

STATEMENT

Petitioner served as indenture trustee for two separate bond issues sold in 1986 and 1988 by the Colorado Springs-Stetson Hills Public Building Authority to finance public improvements to a planned community. The indenture required the bonds to be secured at all times by land having an appraised value of at least 160% of the outstanding principal and interest. Pet. App. A4-A5.

In early 1988, before the second offering, petitioner received an updated appraisal covering both the land securing the 1986 bonds and the separate parcels that were to secure the 1988 bonds. The new appraisal, prepared by the same individual who had supplied the original appraisal in 1986, showed land values essentially unchanged from 1986, even though local real estate values had declined in the interim. Pet. App. A5-A6, A7 n.6. The lead underwriter for the 1986 bonds notified petitioner that the 160% test was not being met for those bonds, and expressed concern that the 1988 appraisal was unreliable. *Id.* at A6. Petitioner's own investigation raised similar questions. *Id.* at A7.

Petitioner, as trustee for the 1986 bonds, at first directed that an independent review of the appraisal be conducted by a different appraiser. Pet. App. A7. After meetings with the issuer, the developer, and others, however, petitioner agreed to defer the independent review until late 1988, at least six months after the 1988 bonds were to be sold. As one condition for petitioner's forbearance, the developer agreed to pledge an additional $2 million in property as security for the 1986 bonds. *Id.* at A8 & n.7. No additional property was pledged as security

for the 1988 bonds, see *id.* at A27, which were sold as scheduled in June 1988. *Id.* at A4. Thereafter the issuer refused to complete the promised independent appraisal, and ultimately defaulted on the 1988 bonds. *Id.* at A9.

Respondents are purchasers of 1988 bonds who brought this securities fraud action against petitioner and others, alleging that the 1988 sale violated Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78j(b), and the Commission's Rule 10b-5, 17 C.F.R. 240.10b-5. In particular, respondents alleged that petitioner knowingly or recklessly aided and abetted the fraud by withdrawing its demand for an immediate independent review of the appraisal despite serious concerns about its accuracy, and by agreeing to delay the review until after the 1988 bonds had been sold. Pet. App. A9, A20, A27 & n.19.

The district court granted summary judgment for petitioner. Pet. App. A29-A36. The court held that recklessness could not satisfy the scienter requirement for aiding-and-abetting liability absent an independent duty on petitioner's part to disclose information, and that there was no genuine issue of material fact as to petitioner's actual knowledge or its duty. *Id.* at A33. The court of appeals agreed (*id.* at A20) that petitioner had no duty to disclose, but held (*id.* at A25) that reckless action—as opposed to mere silence or inaction—that assists a fraud may satisfy the scienter requirement for aiding and abetting even absent such a duty. The court concluded that this case involved more than mere inaction, because petitioner "affirmatively agree[d] to delay the independent review of the [1988] appraisal." *Id.* at A23. Given petitioner's concerns about the appraisal and its knowledge of the upcoming bond sale, the court held that petitioner's decision to allow the delay could support a finding of recklessness, and it remanded the case for trial on that issue. *Id.* at A26-A27.

SUMMARY OF ARGUMENT

Liability for aiding and abetting is fairly encompassed within the established private cause of action under Rule 10b-5. Such liability is supported by the broad language of Section 10(b), read in its statutory and historical context. The federal courts have long and uniformly permitted private plaintiffs to sue defendants for aiding-and-abetting violations of Rule 10b-5, and the history of recent Exchange Act amendments demonstrates that Congress has approved the courts' resolution of the issue. That result is consistent with the deterrent and remedial purposes of the securities laws, and with the role of the private action as a necessary supplement to the Commission's own enforcement efforts. It should not be disturbed.

In order to establish liability for aiding and abetting, a plaintiff must generally establish that the defendant substantially assisted a third party's violation of Rule 10b-5, and did so with some degree of scienter. This case concerns only what degree of scienter is required. In our view, a recklessness standard is appropriate where the required substantial assistance is accomplished through some affirmative action on the part of the defendant, even if the defendant owes the plaintiff no independent duty.

The recklessness standard applies for purposes of primary violations of Rule 10b-5, as well as for purposes of common law fraud. In those cases it discourages deliberate ignorance and, importantly, prevents defendants from escaping liability simply because of the often prohibitive difficulty of proving knowledge or conscious intent on the basis of the circumstantial evidence frequently used in securities fraud cases. The same rationales apply equally to liability for aiding and abetting. In addition, the recklessness standard combines flexibility and predictability more effectively than the alternatives. It requires proof of a high level of culpability in order to establish liability, without limiting such liability so

severely as to impede effective public and private enforcement of the law.

ARGUMENT

I. AIDERS AND ABETTORS MAY BE INCLUDED AS DEFENDANTS IN A PRIVATE ACTION UNDER SECTION 10(B) AND RULE 10B-5

This Court has recently reaffirmed that private actions under Section 10(b) and Rule 10b-5 are "an accepted feature of our securities laws," and that the federal courts have appropriately "accepted and exercised the principal responsibility for the continuing elaboration of the scope" of such actions. *Musick, Peeler & Garrett* v. *Employers Ins.*, 113 S. Ct. 2085, 2089 (1993); see also, *e.g.*, *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 380 (1983). In prior cases involving such elaboration, this Court has looked to statutory language, legislative history, lower court decisions, statutory and common law when the Exchange Act was enacted, and policy considerations.[1] In this case, those factors all counsel confirmation by this Court of the lower courts' uniform conclusion that private actions may properly reach defendants who have aided or abetted violations of Rule 10b-5.

A. Liability For Aiding And Abetting Is Fairly Encompassed Within The Existing Private Action Under Rule 10b-5

Musick, Peeler reiterated this Court's recognition of judicial authority to define the contours of the existing private right of action under Rule 10b-5, and to "flesh out" aspects of the law on which the Act and implementing regulations do not offer conclusive guidance. 113 S. Ct. at

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[1] See, *e.g.*, *Musick, Peeler*, 113 S. Ct. at 2090-2092 (analogous provisions, lower court decisions and policy considerations); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197-206 (1976) (statutory language and legislative history); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 729-749 (1975) (statutory language, judicial treatment, common law, and policy).

2089, quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 737 (1975); see also *Virginia Bankshares, Inc.* v. *Sandberg*, 111 S. Ct. 2749, 2764 (1991) (looking to policy considerations to evaluate "rounding out" substance of existing implied right of action). That is what the lower courts have done with respect to aider-and-abettor liability under Rule 10b-5.

In *Musick, Peeler*, this Court treated contribution rights as merely an aspect of the existing Rule 10b-5 private right of action, even though a right of contribution is typically thought to be "a separate or independent cause of action." 113 S. Ct. at 2088. The Court found the contribution action to be sufficiently aligned with the existing private right because it alleged that those from whom contribution was sought had "committed a wrong that courts have already deemed actionable under federal law." *Ibid.* Under that analysis, aider-and-abettor liability is even more clearly comprehended within the existing cause of action. As this Court has indicated in analogous contexts, for purposes of giving content to recognized private rights of action, such theories of secondary liability should not be regarded as "separate" causes of action, but rather as falling within the existing rights of action under which primary liability is imposed.[2]

In *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 394 (1982), for example, this Court held that where an implied private right of action existed for violations of the Commodity Exchange Act, it

[2] A private plaintiff often sues the same defendant on both primary violation and aiding-and-abetting theories under Rule 10b-5. See, *e.g.*, *Herman & MacLean*, 459 U.S. at 379 n.5. In addition, unlike a contribution claim—which will frequently be brought after conclusion of the lawsuit establishing overall liability, and which may name as defendants persons who were not parties to the original suit—an aiding-and-abetting claim will often be brought as part of the same lawsuit that alleges the primary violation, and name the same defendants. See 9 L. Loss & J. Seligman, *Securities Regulation* 4481 (3d ed. 1992).

"necessarily follow[ed]" that those who conspired to violate the Act were also subject to private suit. The Court did not suggest that it was implying a new or "separate" cause of action for conspiracy, 456 U.S. at 394-395, even though, of course, a conspiracy theory might reach some defendants who had not directly violated the Act. Similarly, in *American Society of Mechanical Engineers, Inc.* v. *Hydrolevel Corp.* (*ASME*), 456 U.S. 556, 568-574 (1982), this Court held a defendant secondarily liable for antitrust violations on the theory that its agent acted with apparent authority, analyzing the case as involving the scope of the existing express right of action.[3] *Id.* at 569-570.

Aiding and abetting, like apparent authority and conspiracy, is a theory of secondary liability, and one properly encompassed by the existing private action under Rule 10b-5. Despite the suggestions to the contrary by petitioner and its amici (see, *e.g.*, SIA Br. 7-10), this case thus involves no more than the rounding out of the existing implied right of action under Rule 10b-5, and there is no need to take as the central inquiry whether Congress would have intended, in the first instance, to create some wholly independent implied cause of action for aiding and abetting. The result is the same, however, under either approach, because there is substantial

[3] In *ASME*, 456 U.S. at 568, the Court cited with approval two federal securities fraud cases involving secondary liability. The first, *Kerbs* v. *Fall River Indus., Inc.*, 502 F.2d 731 (10th Cir. 1974), which the Court cited for its discussion of apparent authority, is also the leading Tenth Circuit decision allowing private actions against aiders and abettors under Rule 10b-5. In the second case, *Holloway* v. *Howerdd*, 536 F.2d 690 (6th Cir. 1976), the Sixth Circuit held a brokerage firm secondarily liable on a respondeat superior theory in a private action under Section 12(2) of the Securities Act of 1933, 15 U.S.C. 77*l*(2). Like *Curran* and *ASME*, each of the cases recognized a theory of secondary liability under an existing right of action, without purporting to imply a new or "separate" cause of action.

evidence of congressional intent to include aiders and abettors in private actions under Rule 10b-5.

B. The Text Of Section 10(b) Supports Imposition Of Liability On Aiders And Abettors

The broad language of Section 10(b) makes it "unlawful for *any person, directly or indirectly*, * * * [t]o use or employ * * * any manipulative or deceptive device or contrivance" "in connection with" the purchase or sale of securities. 15 U.S.C. 78j(b) (emphasis added). Congress thus intended to reach all persons who engage, even if only indirectly, in proscribed activities connected with securities transactions. Moreover, this Court has made clear that the provisions of the securities laws—and Section 10(b) in particular—are to be construed broadly to further their protective and remedial purposes. *Reves* v. *Ernst & Young*, 494 U.S. 56, 72-73 (1990); *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971); *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972). Although the language of Section 10(b) does not in terms mention aiding and abetting, we think that when read in context it is broad enough to encompass liability for such "indirect" violations.[4]

Petitioner argues, citing *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), that aiders and abettors violate Section 10(b) only if their own actions are manipulative or deceptive. Pet. Br. 10, 13-17, 34, 36, 41. That argument ignores Section 10(b)'s "any person" and "directly or indirectly" language, and the fact that in *Ernst & Ernst*, 425 U.S. at 192 n.7, this Court expressly reserved the question whether aiding-and-abetting liability exists under that section. Petitioner also argues (Br. 19 & n.14) that Section 10(b) imposes no aiding-and-abetting liability because the private rights of action expressly provided by Sections 9 and 18 of the Exchange Act, 15 U.S.C. 78i, 78r, impose none. Those sections are textually similar to Section 10(b): Section 9 uses both the "any person" and "directly or indirectly" language, and Section 18 uses "any person." Moreover, Section 9(e) expressly bases liability on "participat[ion]" in prohibited acts, which plainly encompasses aiding and abetting. Contrary to the SIA's assertion (SIA Br. 12 n.9), courts have indicated that aiding-and-abetting liability is available under both sections,[5] and we are aware of no case in which a court has held that such liability is unavailable under either.

Amicus AICPA's similar reliance (Br. 15) on the lack of aiding-and-abetting liability under Sections 11 and 12 of the Securities Act of 1993, 15 U.S.C. 77k, 77*l*, is misplaced for different reasons. Each of those sections sets forth precise categories of permissible defendants; neither contains the "directly or indirectly" language of Section 10(b); and each imposes a culpability requirement (strict liability or negligence) significantly different from that applicable under Section 10(b). They are thus simply inapposite here. Likewise, petitioner and its amici assert that the "controlling person" provisions of Section 20(a) of the Exchange Act, 15 U.S.C. 78t(a) were intended to supplant all other theories of secondary liability, including aiding and abetting. But the text of the section does not support

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[4] See *Geo. H. McFadden & Bro.* v. *Home-Stake Prod. Co.*, 295 F. Supp. 587, 589 (N.D. Okla. 1968) ("directly or indirectly" language in Section 10(b) includes aiders and abettors). See also *SEC* v. *Universal Major Indus. Corp.*, 546 F.2d 1044, 1046 (2d Cir. 1976), cert. denied, 434 U.S. 834 (1977) ("directly or indirectly" language in Section 5 of the Securities Act of 1933, 15 U.S.C. 77e, includes aiders and abettors); *In re Atlantic Financial Management, Inc.*, 784 F.2d 29, 31 (1st Cir. 1986) (noting that majority of courts of appeals have concluded that "any person" and "directly or indirectly" language of Section 10(b) accommodates some forms of secondary liability), cert. denied, 481 U.S. 1072 (1987); p. 11 & note 9, *infra*.

[5] See *Walck* v. *American Stock Exchange, Inc.*, 565 F. Supp. 1051, 1064 (E.D. Pa. 1981) (Section 9), aff'd, 687 F.2d 778 (3d Cir. 1982), cert. denied, 461 U.S. 942 (1983); *In re Caesars Palace Securities Litigation*, 360 F. Supp. 366, 386 (S.D.N.Y. 1973) (Section 18); *Bloor* v. *Dansker*, 523 F. Supp. 533, 542 (S.D.N.Y. 1980), aff'd, 754 F.2d 57 (2d Cir. 1985) (same). See also Pet. Br. 19 n.14.

that view, and the legislative history indicates that, to the contrary, Section 20(a) was "aimed at expanding liability, rather than contracting it." *In re Atlantic Financial Management, Inc.*, 784 F.2d at 32-34. It is therefore not surprising that every court of appeals that has considered whether Section 20(a) constitutes the sole basis for secondary liability has determined that it does not.[6]

Section 10(b), and particularly the term "indirectly," must also be interpreted in light of the legal environment concerning secondary liability at the time of Section 10(b)'s enactment. Aiding-and-abetting liability is deeply rooted in the law, and it was well established in both civil and criminal actions by 1934.[7] Significantly, aiding-and-

[6] See, *e.g.*, *Hollinger* v. *Titan Capital Corp.*, 914 F.2d 1564, 1576-1577 (9th Cir. 1990) (en banc) ("§ 20(a) was intended to supplement, and not to supplant, the common law theory of respondeat superior as a basis for vicarious liability in securities cases"), cert. denied, 499 U.S. 976 (1991). Accord *In re Atlantic Financial Management*, 784 F.2d at 32-34; *Marbury Management, Inc.* v. *Kohn*, 629 F.2d 705, 712-716 (2d Cir.), cert. denied, 449 U.S. 1011 (1980); *Johns Hopkins University* v. *Hutton*, 422 F.2d 1124, 1130 (4th Cir. 1970); *Paul F. Newton & Co.* v. *Texas Commerce Bank*, 630 F.2d 1111, 1118-1119 (5th Cir. 1980); *Holloway*, 536 F.2d at 694-695; *Fey* v. *Walston & Co.*, 493 F.2d 1036, 1051-1052 (7th Cir. 1974); *Commerford* v. *Olson*, 794 F.2d 1319, 1322-1323 (8th Cir. 1986); *Kerbs*, 502 F.2d at 740-741. See also *Sharp* v. *Coopers & Lybrand*, 649 F.2d 175, 182-183 (3d Cir. 1981) (respondeat superior available against broker-dealers and accounting firms in view of "public trust of the firms involved, and the duty to supervise arising therefrom"), cert. denied, 455 U.S. 938 (1982). If Section 20(a) does not supplant respondeat superior, under which an employer may be held strictly liable for the actions of an employee, it certainly should not affect liability for aiding and abetting, which applies only when the defendant's own conduct is culpable.

[7] See, *e.g.*, Restatement of Torts § 876(b) (1939); *Prosser and Keeton on the Law Of Torts* § 46 & nn.8-9 (W. Keeton 5th ed. 1984) (citing pre-1934 civil cases); *Lincoln* v. *Claflin*, 74 U.S. (7 Wall.) 132, 138 (1869) (civil fraud); Act of Mar. 4, 1909, ch. 321, § 332, 35 Stat. 1152 (now codified at 18 U.S.C. 2) (criminal liability); *United States* v. *Peoni*, 100 F.2d 401, 402 (2d Cir. 1938) (Learned Hand, J.) (criminal case discussing English sources of aiding-and-abetting doctrine dating back to fourteenth century).

abetting liability had been applied by that time in securities fraud and related cases both under state "blue sky" statutes and under the common law.[8] In enacting the Exchange Act, Congress intended to expand, not restrict, investor protections under existing law. *Herman & MacLean*, 459 U.S. at 389. It is thus reasonable to conclude that, by selecting the expansive language of Section 10(b), Congress intended to include within its scope the well-established theory of aiding-and-abetting liability. Excluding aiders and abettors from liability would frustrate that intent.

C. Congress Has Declined To Disturb The Courts' Long-standing Interpretation That Aiders And Abettors May Be Included As Defendants In Private Actions Under Rule 10b-5

The right of private plaintiffs to proceed against aiders and abettors under Rule 10b-5 has been widely established in the lower courts for more than 25 years. All 11 of the federal courts of appeals to address this issue have permitted such claims.[9] Congress may fairly be presumed

[8] *E.g.*, *Randall* v. *California Land Buyers' Syndicate*, 20 P.2d 331, 333 (Cal. 1933) (directors who aid and assist issuance of stock in violation of blue sky statute civilly liable to purchaser of stock); *Noll* v. *Woods*, 203 N.W. 848, 849-850 (Mich. 1925) (investment company president involved in sale of stock liable to purchaser under blue sky statute that referred only to "investment companies" and "dealers"); *Board of Trade* v. *Price*, 213 F. 336, 337 (8th Cir. 1914) (one who "aids" and "assists" purloining of market quotations may be enjoined in civil action). By early 1933, the blue sky laws of 11 states and the Territory of Hawaii had created private rights of action that expressly imposed liability on aiders and abettors. See Abrams, *The Scope Of Liability Under Section 12 of the Securities Act of 1933: "Participation" and the Pertinent Legislative Materials*, 15 Fordham Urb. L. J. 877, 945 (1987) (citing authorities).

[9] See the cases cited in notes 10-11 of the government's brief at the petition stage (U.S. Amicus Br. 9-10). The only court of appeals not to address the issue has permitted Rule 10b-5 claims against aiders and abettors in Commission actions. *Dirks* v. *SEC*, 681 F.2d 824, 844 (D.C. Cir. 1982), rev'd on other grounds, 463 U.S. 646 (1983). See also *Zoelsch*

to be aware of such an important and widespread judicial interpretation of a statute, and to adopt that interpretation when it comprehensively reenacts or amends the statute without relevant change. *Lorillard* v. *Pons*, 434 U.S. 575, 580-581 (1978); *Cannon* v. *University of Chicago*, 441 U.S. 677, 698-699 (1979).

In *Herman & MacLean*, the Court unanimously confirmed the cumulative nature of the Rule 10b-5 implied private right of action, rejecting the argument that the plaintiff was limited to express rights. The Court noted that, in 1975, Congress comprehensively amended the Securities Exchange Act, undertaking the "most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act in 1934." 459 U.S. at 384-85 (citations omitted). Congress did so without overturning the prevalent judicial interpretation treating the Section 10(b) private right of action as cumulative. "In light of this well-established judicial interpretation, Congress' decision to leave Section 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action."[10] 459 U.S. at 385-386.

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v. *Arthur Andersen & Co.*, 824 F.2d 27, 35-36 (D.C. Cir. 1987) (dismissing claim on facts but acknowledging elements of aider-and-abettor liability recognized by other courts of appeals). Commentators have likewise recognized aiding-and-abetting liability under the Rule 10b-5 private action. See Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution*, 120 U. Pa. L. Rev. 597, 632-633, 638, 645-646 (1972); 5B A. Jacobs, *Litigation and Practice Under Rule 10b-5* § 40.02 (2d ed. 1993).

[10] Similarly, in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. at 376, the Court found that by the time Congress "comprehensively reexamined and strengthened" the Commodity Exchange Act in 1974, federal courts had consistently recognized an implied private right of action under that statute. Accordingly, the implied right was part of the "contemporary legal context," and the fact that the 1974 amendments "left intact the statutory provisions under which the federal courts had implied a cause of action * * * evidence[d] that Congress affirmatively intended to preserve that remedy." *Id.* at 381-382.

That principle applies with even greater force to private aiding and abetting liability under Section 10(b). When Congress comprehensively amended the Exchange Act in 1975, it specifically focused on the private action, overturning court decisions involving Section 10(b) private rights of action with which it disagreed.[11] It did not, however, disturb the by then widespread recognition by the federal courts that aiders and abettors could be sued in such actions,[12] although it plainly knew how to do so had it desired such a result.

Later Exchange Act amendments also reflect congressional approval both of implied private actions and of aiding and abetting liability. In 1977, Congress enacted the Foreign Corrupt Practices Act, Pub. L. No. 95-213, 91 Stat. 1494, which among other things, amended the Exchange Act. The House Committee explicitly approved existing Exchange Act implied private rights of action,

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[11] See Section 21(g) of the Exchange Act, 15 U.S.C. 78u(g) (prohibiting consolidation of Commission injunctive actions with private actions in the absence of Commission consent); S. Rep. No. 75, 94th Cong., 1st Sess. 75-77 (1975) (citing decisions disapproved by Congress).

[12] For some ten years prior to 1975 a large and growing body of courts, including five federal courts of appeals, had embraced aiding and abetting liability in Rule 10b-5 private actions. See, *e.g.*, *Brennan* v. *Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 680-681 (N.D. Ind. 1966); *Buttrey* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135, 144 (7th Cir.), cert. denied, 396 U.S. 838 (1969); *Landy* v. *FDIC*, 486 F.2d 139, 162-163 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974); *Kerbs*, 502 F.2d at 740; *Zabriskie* v. *Lewis*, 507 F.2d 546, 554 (10th Cir. 1974); *Strong* v. *France*, 474 F.2d 747, 752 (9th Cir. 1973); *Lanza* v. *Drexel & Co.*, 479 F.2d 1277, 1278 (2d Cir. 1973) (en banc) (dictum); *Green* v. *Jonhop, Inc.*, 358 F. Supp. 413, 419 (D. Or. 1973); *Anderson* v. *Francis I. DuPont & Co.*, 291 F. Supp. 705, 709 (D. Minn. 1968); *Fischer* v. *Kletz*, 266 F. Supp. 180, 190 (S.D.N.Y. 1967); *Pettit* v. *American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963). See also Ruder, *supra*, 120 U. Pa. L. Rev. at 599. As petitioner concedes (Br. 29), no court has held to the contrary.

expressing its intent that "the courts shall recognize a private cause of action based on this legislation, as they have in cases involving other provisions of the Securities Exchange Act, on behalf of persons who suffer injury as a result of prohibited [practices]." H.R. Rep. No. 640, 95th Cong., 1st Sess. 10 (1977). Likewise, in 1984 Congress passed the Insider Trading Sanctions Act, Pub. L. No. 98-376, § 2, 98 Stat. 1264, which added a treble civil penalty provision applicable in Commission enforcement actions to tippers who aid or abet insider trading violations. 15 U.S.C. 78u(d)(2)(A) (Supp. V 1987). The House Report particularly "endorse[d] the judicial application of the concept of aiding and abetting liability to achieve the remedial purposes of the securities laws." H.R. Rep. No. 355, 98th Cong., 2d Sess. 10 (1983). In addition to a Commission case, the report cited *Rolf* v. *Blyth, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir.), cert. denied, 439 U.S. 1039 (1978), a leading Second Circuit decision that held an aider and abettor liable in a private action under Rule 10b-5.

Even more recently, Congress amended the Exchange Act in the Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 5, 102 Stat. 4680 That Act added Exchange Act Section 20A, which provides an express action to contemporaneous traders for insider trading violations, and states that "[n]othing in this section shall be construed to limit or condition * * * the availability of any cause of action implied from a provision of this title." 15 U.S.C. 78t-1(d); see also H.R. Rep. No. 910, 100th Cong., 2d Sess. 27 n.23 (1988) (1988 Act would not "affect the availability of any other theories of liability, such as aiding and abetting[,] * * * in appropriate circumstances"). Last term this Court construed the enactment of Section 20A as a congressional "acknowledgement" of the existence of the private action under Rule 10b-5, and of judicial authority "to shape, within

limits, the 10b-5 cause of action." *Musick, Peeler*, 113 S. Ct. at 2089.[13]

In the face of this recent evidence of congressional approval, petitioner (Br. 20-22 & n.15) and its amici (AICPA Br. 12 n.7; SIA Br. 15-16) assert to the contrary that Congress's "rejection" of amendments proposed in 1957, 1959 and 1960 demonstrates an intent to exclude aiders and abettors from liability. That argument mischaracterizes the legislative history. The proposal in question, originally part of a proposed comprehensive revision of the federal securities laws, would have amended Exchange Act Section 20(b), and was intended to confirm the Commission's right (then established in the courts) to proceed against aiders and abettors. It was not intended to address private rights of action. See *Hearings on Senate Bills 1178-1182 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 86th Cong., 1st Sess. 335 (1959) (Commission statement). Moreover, the proposal was not "rejected." In 1960, the responsible House committee reported favorably on the original legislation, and the Senate passed a modified version, which would have amended the Commission's express right to seek injunctive relief under Exchange Act Section 21 (referred to incorrectly in the Senate report as Section 20(b)). See H.R. Rep. No. 2177, 86th Cong., 2d Sess. (1960); S. Rep. No. 1757, 86th Cong., 2d Sess. (1960); 106 Cong. Rec. 15,613, 16,457-16,458 (1960). Further consideration of the proposal was postponed, however, "due to the lack of time remaining in the term," L. Loss & J. Seligman, *Securities Regulation* 205-206 & n.80 (2d ed. 1961) (quoting 106 Cong. Rec. 15,611-15,612 (1960)); see also *Brennan*, 259 F. Supp. at 677-680, and it was not revived in subsequent Congresses. In any event, the more recent legislative record, developed at a time when the courts had uniformly

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[13] The history of the 1988 legislation likewise acknowledges the existence of the implied private right under Rule 10b-5. See, *e.g.*, 134 Cong. Rec. 17,218, 17,220 (1988) (remarks of Senator Garn).

approved aiding and abetting liability under 10(b), provides far more compelling evidence of congressional intent.

D. Policy Considerations Support The Inclusion Of Aiders And Abettors As Defendants

As this Court has noted, the Commission has only limited resources to detect or investigate federal securities law violations, and private actions accordingly serve as "a necessary supplement to Commission action." *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964); *Basic Inc.* v. *Levinson*, 485 U.S. 224, 231 (1988). In the Commission's own actions under Rule 10b-5, the established right to proceed against aiders and abettors is critical to effective enforcement. See note 15, *infra*. The private right of action's effectiveness as a supplement to Commission enforcement would be severely undercut if it did not also reach aiders and abettors.

Private actions also serve the compensatory purposes of the securities laws. Although the Commission may seek certain monetary relief, its remedies are designed primarily to deter violations by making them unprofitable, rather than to make investors whole. See *SEC* v. *Coven*, 581 F.2d 1020, 1027-1028 (2d Cir. 1978), cert. denied, 440 U.S. 950 (1979). Accordingly, the primary means of compensating injured investors remains the private action, and all participants in a fraud should be liable in order to ensure full recovery.

Amicus AICPA asserts (Br. 17-20) that aiding and abetting liability sweeps too broadly and that it is too easy for a plaintiff to allege that routine business functions aid and abet violations of the securities laws. It is possible, of course, for any private right of action under the securities laws to give rise to some unfounded or vexatious claims. The proper response to such problems, however, is not to jettison a whole class of defendants or substantive theory of liability (such as aiding and abetting), but rather to

fashion safeguards to reduce frivolous claims against both primary violators and aiders and abettors.[14]

Finally, as noted above, it has long been settled in the lower courts that private plaintiffs may sue aiders and abettors under Rule 10b-5. Many hundreds of reported cases reflect this uniformity. A decision by this Court dispensing with aiding and abetting liability in private actions would unquestionably have a major impact on the well-established law governing such actions. The Court should thus give considerable weight to the lower courts' longstanding acceptance of the aiding and abetting principle of liability. See *Musick, Peeler*, 113 S. Ct. 2091; *Blue Chip Stamps*, 421 U.S. at 733; see also *Curran*, 456 U.S. at 376. Indeed, in discussing the implied private right of action under Rule 10b-5, this Court has acknowledged that a rule of law consistently applied for several decades may become established "beyond peradventure." *Herman & MacLean*, 459 U.S. at 380. Particularly in light of the evidence of congressional approval discussed above, any decision to reverse direction and reject aider and abettor liability under Rule 10b-5 would, at this late date, be better left to Congress.[15]

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[14] The AICPA also asserts (Br. 17-19), as a policy reason for eliminating aiding and abetting liability, that an "explosion" of litigation against accountants has led to their "virtually limitless liability." If so, however, then the "explosion" is taking place within the overall bounds of existing litigation: the number of district court securities laws cases appears not to have increased during the last two decades. See *Concerning Private Litigation Under the Federal Securities Laws: Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 103d Cong., 1st Sess. 8-11 (1993) (testimony of William R. McLucas, Director of the Commission's Division of Enforcement). In addition, much of the asserted increase in liability may be based on state law negligence claims, and hence would not be affected by changes in the federal securities laws or private rights of action under them. *Ibid.*

[15] Commission actions under Exchange Act Section 21(d), while not involved here, also routinely seek relief against aiders and abettors. For decades, the courts have uniformly permitted the Commission to

II. RECKLESSNESS SATISFIES THE SCIENTER REQUIREMENT FOR AIDING-AND-ABETTING LIABILITY UNDER SECTION 10(B) AND RULE 10B-5

A. A Recklessness Standard For Aiding-And-Abetting Liability Comports With The Language And Purposes Of Section 10(b) And Rule 10b-5, While A Conscious Intent Standard Would Frustrate The Purposes Of The Statute And The Rule

The precise formulation for establishing aiding and abetting liability varies among the circuits, but in general a plaintiff must prove: (1) a Rule 10b-5 violation by another; (2) substantial assistance by the defendant in achieving the violation; and (3) scienter on the part of the defendant.[16] This case concerns only the last element of the test. In our view, the court of appeals correctly adopted a recklessness standard for aiding-and-abetting liability under Rule 10b-5 where the defendant's affirmative acts include such defendants in Rule 10b-5 cases. *E.g.*, *SEC* v. *Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975); *SEC* v. *Timetrust, Inc.*, 28 F. Supp. 34, 43 (N.D. Cal. 1939) (action under Securities Act Section 17(a)). In fiscal 1992, more than 15% of the Rule 10b-5 cases brought by the Commission included an assertion of liability for aiding and abetting. Elimination of such liability would sharply diminish the effectiveness of Commission actions. Moreover, because Commission cases are brought by a government agency, are prophylactic in nature, and seek equitable relief, the rationale for permitting aiding and abetting liability in those actions is somewhat different from (and even stronger than) the rationale in private damages actions. Accordingly, whatever the result for private actions, the Court's decision should preserve the availability of aiding and abetting liability in Commission actions.

[16] See U.S. Cert. Br. 10 n.11 (collecting cases). The Seventh Circuit's test is more restrictive, requiring that the aider and abettor "(1) commit one of the 'manipulative or deceptive' acts prohibited under section 10(b) and rule 10b-5 (2) with the same degree of scienter that primary liability requires." *Robin* v. *Arthur Young & Co.*, 915 F.2d 1120, 1123 (7th Cir. 1990), cert. denied, 111 S. Ct. 1317 (1991).

assisted another's violation of the Rule.[17] Recklessness satisfies the scienter requirement for primary violations of Rule 10b-5, and the rationale used in that setting applies equally to aiding and abetting.[18]

1. *The recklessness standard applies to primary liability.* In *Ernst & Ernst* v. *Hochfelder*, this Court examined the language of Section 10(b) and evidence of congressional intent, and concluded that the statute requires "some element of scienter and cannot be read to impose liability for negligent conduct alone," 425 U.S. at 201, for "wholly faultless conduct," *id.* at 198, or for acts performed "in good faith," *id.* at 206. A recklessness standard does not, of course, impose liability for negligent,

[17] The Tenth Circuit, like most courts of appeals (see U.S. Cert. Br. 11 n.13), follows the Seventh Circuit's definition of recklessness, under which a reckless action would be "a highly unreasonable [action], involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Sundstrand Corp.* v. *Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir.) (citation omitted), cert. denied, 434 U.S. 875 (1977).

[18] One possible exception involves an alleged aider and abettor who has no independent duty to disclose or act, and whose only substantial assistance consists of silence and inaction. Under those circumstances, courts of appeals have indicated that conscious intent to aid the fraudulent scheme is or may be required. See, *e.g.*, Pet. App. A17-A18 (citing cases). This case, however, raises no such question, and we take no position on that issue. (We also take no position on the question, not raised here, whether petitioner in fact owed respondents any independent duty of disclosure.) We agree with the court of appeals, *id.* at A6-A8, A23, that petitioner's conduct constituted affirmative action. Petitioner's retraction of its demand for an independent appraisal is unlike conduct that the courts have held to consist of mere silence and inaction. See, *e.g.*, *Cleary* v. *Perfectune, Inc.*, 700 F.2d 774, 776-779 (1st Cir. 1983) (persons named as directors in offering memorandum without their knowledge or consent, and who had taken no actions and made no representations); see also Pet. App. A16-A19 (finding genuine factual dispute over whether another defendant in this case substantially assisted the alleged fraud through silence and inaction).

faultless or good faith conduct. In analyzing the culpability standard under Section 10(b), the Court in *Ernst & Ernst* considered the express civil remedies in favor of purchasers or sellers of securities under the Securities Act and the Exchange Act. *Id.* at 206-208. For purposes of this case, it is significant that recklessness is sufficient to satisfy the culpability requirements under those sections.[19]

Moreover, the Court recognized in *Ernst & Ernst* that "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct," and indicated, without deciding, that recklessness could satisfy the scienter requirement.[20] 404 U.S. at 194 n.12. The *Ernst & Ernst* Court likely had common law fraud in mind as one area of law where recklessness is considered to be a form of intentional conduct. See *Rolf* v. *Blyth, Eastman Dillon & Co.*, 570 F.2d at 45 (common law as source of securities law concepts); *Straub* v. *Vaisman & Co.*, 540 F.2d 591, 597 (3d Cir. 1976) (common law deceit and misrepresentation relevant in interpreting Rule 10b-5); *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1024 (6th Cir. 1979) (useful, after *Ernst & Ernst*, to analogize between common law

[19] See Securities Act §§ 11 (strict liability and negligence), 12(2) (negligence) and 15 (negligence), 15 U.S.C. 77k, 77*l*(2) and 77*o*; Exchange Act §§ 9(e) ("willfully," a term this Court has interpreted in other contexts to include reckless disregard, see *Hazen Paper Co.* v. *Biggins*, 113 S. Ct. 1701, 1708-1709 (1993)), 18 ("good faith" defense), and 20 ("good faith" defense), 15 U.S.C. 78i, 78r and 78t.

[20] Petitioner erroneously suggests that the Court viewed Section 10(b) as requiring "conscious intent." Pet. Br. 36; see also AICPA Br. 23; SIA Br. 18-21. The Court, however, stated only that scienter "refers to a mental state embracing intent to * * * defraud," and that the statute proscribes "knowing or intentional misconduct," *Ernst & Ernst*, 425 U.S. at 194 n.12, 197, and it explicitly noted that recklessness might be considered "a form of intentional conduct" for these purposes. *Id.* at 194 n.12. Moreover, " '[k]nowing' is a word laden with common law connotations: at common law, reckless conduct is viewed as a form of knowing conduct." *Rolf* v. *Blyth, Eastman Dillon & Co.*, 570 F.2d at 45.

fraud and Rule 10b-5).[21] For purposes of common law fraud, recklessness is considered to be a form of intentional conduct, and satisfies the scienter requirement for primary liability.[22] One who acts with reckless disregard of potentially harmful consequences is just as culpable as one who acts with actual knowledge of such consequences.[23]

[21] Petitioner (Br. 36) and amicus SIA (Br. 21) incorrectly suggest that criminal law is the proper source to determine the scienter required for aiding and abetting liability. In fact, the courts have properly looked to common law fraud for guidance with respect to scienter under Rule 10b-5. See, *e.g.*, *Rolf*, 570 F.2d at 46; AICPA Br. 22; Johnson, *Liability for Reckless Misrepresentations and Omissions under Section 10(b) of the Securities Exchange Act of 1934*, 59 U. Cin. L. Rev. 667, 696 (1991) (cited by both SIA and AICPA). The decisions of this Court cited by the SIA (Br. 21 n.21) stand only for the proposition that courts should evaluate whether relevant market conditions or other circumstances are so different from those under which the common law developed that a particular common law rule may not furnish complete or appropriate guidance for modern securities law. See *Basic Inc.* v. *Levinson*, 485 U.S. at 243-244; *Herman & MacLean*, 459 U.S. at 388-389; *Blue Chip Stamps*, 421 U.S. at 744-745. Such an evaluation in this case reveals no difference in circumstances pertinent to the degree of culpability that should be required to impose liability for aiding and abetting a fraud. Moreover, both *Basic Inc.* and *Herman & MacLean* rejected common law analogies that would have tended to thwart the Exchange Act's protective purposes; here, in contrast, reliance on the common law would *avoid* a restrictive scienter requirement that would conflict with those purposes. See Johnson, *supra*, 50 U. Cin. L. Rev. at 710.

[22] See Restatement (Second) of Torts § 526(b), comment e (1977); *Prosser & Keeton*, *supra*, § 107, at 741-742.

[23] *Derry* v. *Peek*, 14 App. Cas. 337 (H.L. 1889) ("a person making a false statement [who] had shut his eyes to the facts, or purposely abstained from inquiring into them, * * * [is] just as fraudulent as if he had knowingly stated that which was false"); *State Street Trust Co.* v. *Ernst*, 15 N.E.2d 416, 418-419 (N.Y. 1938) (accountant's "refusal to see the obvious, a failure to investigate the doubtful, if sufficiently gross, may furnish evidence leading to an inference of fraud"; "heedlessness and reckless disregard of consequence may take the place of deliberate intention"). See also *Lehigh Zinc & Iron Co.* v. *Bamford*, 150 U.S. 665, 673 (1893) (one who makes representations of material facts, when he is

One underlying rationale for this rule is, of course, to discourage deliberate ignorance of facts indicating fraud. See, *e.g.*, *State Street Co.* v. *Ernst*, 15 N.E.2d 416, 418-419 (N.Y. 1938). The rule also prevents a defendant from escaping liability simply by denying, falsely, any conscious intent to defraud. Proving such intent can be a daunting task, particularly when (as is frequently the case) the evidence is entirely circumstantial. In the face of these difficulties, the Commission and private parties routinely rely on proof of recklessness in complex Rule 10b-5 fraud cases. Insistence on a conscious intent standard would permit much deliberately wrongful conduct to escape liability, and "would for all intents and purposes disembowel the private cause of action under [Section] 10(b)." *Rolf*, 570 F.2d at 47.[24]

A recklessness standard is therefore a practical necessity for the effectiveness of aiding and abetting liability—both in private actions such as this one and, importantly, in the Commission's own enforcement program. Scienter is required under Rule 10b-5 in both types of action (see *Aaron* v. *SEC*, 446 U.S. 680 (1980)), and the same standard will presumably be applied in both. Since *Ernst & Ernst*, every court of appeals that has considered whether recklessness suffices for primary

conscious that he has no knowledge of the existence of such facts, is as much responsible for the injurious consequences as if he actually knew them to be false).

[24] See also *Mansbach*, 598 F.2d at 1025; *Hackbart* v. *Holmes*, 675 F.2d 1114, 1118 (10th Cir. 1982); *G. A. Thompson & Co.* v. *Partridge*, 636 F.2d 945, 961 n.32 (5th Cir. 1981); cf. *Herman & MacLean*, 459 U.S. at 390-391 n.30 ("If anything, the difficulty of proving the defendant's state of mind supports a lower standard of proof."). Petitioner and its amici offer no response to this weighty consideration, even though the authorities they cite view it as a reason why the recklessness standard is appropriate. See Ruder, *supra*, 120 U. Pa. L. Rev. at 634-636; Johnson, *supra*, 59 U. Cin. L. Rev. at 679.

liability under Rule 10b-5 has held that it does,[25] and this Court should now confirm that conclusion.

2. *The rationale for the recklessness standard applies to aiding and abetting liability*. The reasons for adopting the recklessness standard for primary liability under Rule 10b-5 apply equally to aiding and abetting. The language of Section 10(b) considered by the Court in *Ernst & Ernst* is, of course, the same in both cases. Moreover, courts in fraud cases have recognized that recklessness satisfies the scienter requirement for common law aiding and abetting. See generally Restatement (Second) of Torts, *supra*, § 876(b); see, *e.g.*, *FDIC* v. *First Interstate Bank, N.A.*, 885 F.2d 423, 431 (8th Cir. 1989) (actual knowledge not required for aiding and abetting common law fraud). Requiring conscious intent would encourage aiders and abettors, as it would primary violators, to deliberately ignore facts indicating fraud. And proving conscious intent to defraud is equally difficult whether the case involves primary liability or aiding and abetting. See Kuehnle, *Secondary Liability Under the Federal Securities Laws*, 14 J. Corp. L. 313, 324, 327 (1988). Since *Ernst & Ernst*, every court of appeals that has considered whether recklessness satisfies the scienter requirement for aiding and abetting under Rule 10b-5 has held that it does in at least some circumstances.[26]

[25] See U.S. Cert. Br. 11 n.13. Several courts of appeals have expressly relied on the common law. See *id.* at 13 n.16. The courts have also generally relied both on the difficulties of proving conscious intent and on the broad remedial purposes of Section 10(b). See *Mansbach*, 598 F.2d at 1024-1025; *Hackbart*, 675 F.2d at 1117; *Sundstrand*, 553 F.2d at 1044. Prior to *Ernst & Ernst*, many courts that required scienter had held that recklessness sufficed. See, *e.g.*, *Lanza* v. *Drexel & Co.*, 479 F.2d 1277, 1306 (2d Cir. 1973) (en banc); *Coffey*, 493 F.2d at 1314. Recklessness also satisfies scienter under the American Law Institute's proposed Federal Securities Code. ALI, *Federal Securities Code* §§ 202(147), 202(86) & comment 8 (1980).

[26] See U.S. Cert. Br. 12 n.14. As with primary liability, many courts requiring scienter for Rule 10b-5 aiding and abetting prior to *Ernst & Ernst* also held that recklessness sufficed. See, *e.g.*, *Rochez*

Furthermore, a recklessness standard for aiding and abetting comports with the purposes of Section 10(b). See Ruder, *supra*, 120 U. Pa. L. Rev. at 645-646. This Court has long noted that Section 10(b) serves broad remedial purposes, and has stated that the securities laws should be liberally construed to effectuate those purposes. See, *e.g.*, *Herman & MacLean*, 459 U.S. at 386-387. By facilitating enforcement of Rule 10b-5, the recklessness standard promotes the congressional policy embodied in the 1934 Act. See *Basic Inc.*, 485 U.S. at 245. The higher conscious intent standard, by contrast, would impede both Commission and private enforcement of the Act, thereby impairing the securities laws' function of protecting investors.[27]

B. The Recklessness Standard Is Flexible, Predictable, And Preferable To Other Approaches

In addition to the approach adopted by the court of appeals here—applying a recklessness standard where the aider and abettor's conduct consisted of affirmative

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Bros. v. *Rhoades*, 527 F.2d 880, 886 (3d Cir. 1975); *SEC* v. *First Securities Co.*, 463 F.2d 981, 987 (7th Cir.), cert. denied, 409 U.S. 880 (1972); *SEC* v. *Spectrum, Ltd.*, 489 F.2d 535, 541 (2d Cir. 1973). See also *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 868 (2d Cir. 1968) (en banc) (Friendly, J., concurring) (acknowledging that recklessness may be a form of scienter), cert. denied, 394 U.S. 976 (1969).

[27] Petitioner's reliance (Br. 41, 48; SIA Br. 8, 27-28) on *Chiarella* v. *United States*, 445 U.S. 222 (1980) in determining scienter for aiding-and-abetting liability is misplaced. *Chiarella* dealt with an alleged primary violator who was silent and had no duty to speak. Petitioner does not dispute that the primary violators in this case were not silent, but made affirmative misrepresentations. The *Chiarella* duty analysis simply does not apply to such misrepresentations. Moreover, *Chiarella* did not discuss what constitutes scienter. Amicus SIA's reliance (Br. 27-28) on *Dirks* v. *SEC*, 463 U.S. 646 (1983), is also misplaced. The Court expressly stated in *Dirks* that the issue in the case was not scienter, but only whether the alleged primary violator had engaged in wrongful conduct. 463 U.S. at 663 n.23.

action[28]—the lower courts have used two other main approaches in analyzing the scienter requirement for aiding-and-abetting liability under Rule 10b-5: the "duty" approach and the "sliding scale" approach.

Applying the former approach, some courts have held that recklessness does not suffice for Rule 10b-5 aiding-and-abetting liability absent breach of a duty to disclose or act. See U.S. Cert. Br. 15-16 & nn.20-21. Absent such a breach, a plaintiff must always prove conscious intent to defraud, even if the defendant's substantial assistance consisted of affirmative action. See, *e.g.*, *Ross* v. *Bolton*, 904 F.2d 819, 824 (2d Cir. 1990); *Schatz* v. *Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991).

Several other courts have applied the "sliding scale" approach, under which the scienter standard depends both on the nature of the conduct and on whether the defendant had a duty to disclose.[29] A defendant who affirmatively acts to assist a fraudulent scheme but who has no duty to disclose is liable for aiding and abetting only if the plaintiff can prove "conscious intent[,] unless * * * the assistance is unusual, * * * in which case recklessness will suffice." *Akin* v. *Q-L Investments, Inc.*, 959 F.2d 521, 531 (5th Cir. 1992).

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[28] The approach in this case is essentially the same as that taken by the Ninth Circuit in *Levine* v. *Diamanthuset, Inc.*, 950 F.2d 1478, 1484-1485 & nn.4-5 (9th Cir. 1991), and is consistent with those decisions that have suggested that recklessness would satisfy the scienter requirement in *all* Rule 10b-5 aiding-and-abetting cases. See *Herm* v. *Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *DCD Programs, Ltd.* v. *Leighton*, 833 F.2d 183, 188-189 (9th Cir. 1987).

[29] See, *e.g.*, *Woodward* v. *Metro Bank*, 522 F.2d 84, 95-97 (5th Cir. 1975); *Metge* v. *Baehler*, 762 F.2d 621, 624-625 (8th Cir. 1985), certs. denied, 474 U.S. 1057 and 474 U.S. 1072 (1986); *Schneberger* v. *Wheeler*, 859 F.2d 1477, 1480-1481 (11th Cir. 1988), cert. denied, 490 U.S. 1091 (1989). Petitioner uses the term "sliding scale" differently (Br. 38-40), combining the "duty" and "sliding scale" approaches discussed here to produce a "majority rule sliding scale" approach.

In contrast to those approaches, the standard we urge focuses on recklessness—that is, an extreme departure from ordinary care (see note 17, *supra*). It requires a state of mind closer to conscious intent than to gross negligence. In our view, it combines flexibility and predictability more effectively than either the "duty" or the "sliding scale" approach. What is a "highly unreasonable" omission or an "extreme" departure from "standards of ordinary care" turns on the facts of each case. That focus accords with the judicial view that aiding-and-abetting liability should be determined flexibly, based on particular circumstances. See, *e.g.*, *Camp* v. *Dema*, 948 F.2d 455, 459 (8th Cir. 1991); *Woodward*, 522 F.2d at 94; *FDIC* v. *First Interstate Bank, N.A.*, 885 F.2d 423, 429 (8th Cir. 1989).

The "duty" approach lacks this flexibility and places too severe a limit on Rule 10b-5 aiding and abetting liability based on a defendant's affirmative acts. The source of the idea that scienter for aiding and abetting liability should turn on a duty to disclose or act is unclear. Where aiding and abetting consists of silence and inaction, requiring a breach of duty before imposing liability is arguably consistent with the common law precept that mere bystanders are not liable if they have no duty to speak or act.[30] Where the defendant takes affirmative action, however, the rationale for such protection does not exist.[31] To engraft a duty requirement on Rule 10b-5 aiding and

[30] See *Prosser & Keeton*, *supra*, § 56, at 373-377 (citing cases); *Louisville & N. R.R.* v. *Scruggs & Echols*, 49 So. 399, 400 (Ala. 1909) ("law imposes no duty on one man to aid another"). See also Restatement (Second) of Torts, *supra*, § 551(2)(a). Petitioner claims (Br. 47) that a rule distinguishing action from inaction is unworkable. That distinction, however, is fundamental in the law, including in traditional determinations of "bystander" liability.

[31] See *Prosser & Keeton*, *supra*, § 56, at 378-382 (citing cases); *Black* v. *New York, N.H. & H. R.R.*, 79 N.E. 797, 798 (Mass. 1907) (once aid is undertaken, actor must use ordinary care); *Zelenko* v. *Gimbel Bros.*, 287 N.Y.S. 134, 135 (Sup. Ct. 1935) aff'd, 287 N.Y.S. 136 (App. Div. 1936) (same).

abetting liability in the latter circumstances would serve no useful purpose, and would only pointlessly hinder both Commission and private enforcement of the securities laws.

While flexible, the recklessness standard sets a high level of culpability: a form of intent, and a standard clearly distinguishable from negligence.[32] Fears of unwarranted liability are thus exaggerated. See Ruder, *supra*, 120 U. Pa. L. Rev. at 632-633, 638.[33] Experience suggests that courts have not hesitated, in appropriate circumstances, to find defendants (either primary violators or aiders and abetters) in Rule 10b-5 actions not liable under a recklessness standard.[34] Indeed, if the Court upholds

[32] The Court recognized this distinction in *Ernst & Ernst*, 425 U.S. at 193-194 n.12, 197, 199, 201. See also *Sanders* v. *John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977), cert. denied, 450 U.S. 1005 (1981) (recklessness should be regarded as a "lesser form of intent" rather than "merely a greater degree of ordinary negligence"). The *Sundstrand* standard (see note 17, *supra*) is generally considered to impose a relatively high level of culpability. See, *e.g.*, *Broad* v. *Rockewell Int'l Corp.*, 642 F.2d 929, 961-962 (5th Cir.), cert. denied, 454 U.S. 965 (1981); *G.A. Thompson & Co.*, 636 F.2d at 945; *White* v. *Sanders*, 689 F.2d 1366, 1367 n.4 (11th Cir. 1982). Historically, moreover, the recklessness standard developed in contradistinction to negligence. At common law, recklessness, like conscious intent, involves a culpable mental state, while negligence does not. See *Prosser & Keeton*, *supra* § 107; Restatement (Second) of Torts, *supra*, §§ 552 comment a, 526(b) comment e. Cf. *Hazen Paper Co.* v. *Biggins*, 113 S. Ct. 1701, 1708-1710 (1993) ("willfulness" equated to "knowledge or reckless disregard").

[33] In relying (Pet. Br. 49) on the statement that "[k]nowledge of wrongful purpose thus becomes a crucial element in aiding and abetting" cases, 120 U. Pa. L. Rev. at 630-631, petitioner overlooks Ruder's elaboration that recklessness satisfies that requirement. *Id.* at 636, 638.

[34] See, *e.g.*, *Marbury Management, Inc.* v. *Kohn*, 470 F. Supp. 509 (S.D.N.Y. 1979) (alleged aiders and abettors); *Lingenfelter* v. *Title Ins. Co.*, 442 F. Supp. 981 (D. Neb. 1977) (same); *Hoffman* v. *Estabrook & Co.*, 587 F.2d 509 (1st Cir. 1978) (alleged primary violators); *Cook* v. *Avien, Inc.*, 573 F.2d 685 (1st Cir. 1978) (same); *Decker* v. *Massey-Ferguson, Ltd.*, 681 F.2d 111 (2d Cir. 1982) (same); *State Teacher's Retirement Board* v. *Fluor Corp.*, 654 F.2d 843 (2d Cir. 1981) (same);

application of that standard in this case, petitioner will have every opportunity to demonstrate at trial that its actions were in fact routine and reasonable, or otherwise not reckless. Thus, although some courts have expressed concern that participants in routine business transactions should not be liable for aiding and abetting absent conscious intent,[35] such concern is not warranted. The recklessness standard accommodates distinctions among varying types of assistance, as well as differences in the level, remoteness, and routineness of the conduct.[36]

The recklessness standard is also predictable. A potential aider and abettor knows that his affirmative conduct will be judged under a recklessness standard according to objective standards applicable to the particular situation. The "sliding scale" approach lacks this predictability; indeed, the need to categorize varying fact patterns simply in order to determine the applicable standard of scienter complicates the analysis and increases the possibility of conflicting results. Finally, to the extent that the "sliding scale" approach ultimately imposes a conscious intent standard, it adversely affects enforcement of the securities laws.[37]

McLean v. *Alexander*, 599 F.2d 1190 (3d Cir. 1979) (same); *Coleco Industries, Inc.* v. *Berman*, 567 F.2d 569 (3d Cir. 1977), cert. denied, 439 U.S. 830 (1978) (same); *Broad* v. *Rockwell Int'l Corp.*, 642 F.2d 929 (5th Cir.), cert. denied, 454 U.S. 965 (1981) (same); *Croy* v. *Campbell*, 624 F.2d 709 (5th Cir. 1980) (same); *Sanders* v. *John Nuveen & Co.* 554 F.2d 790 (7th Cir. 1977), cert. denied, 450 U.S. 1091 (1989) (same).

[35] See, *e.g.*, *Camp*, 948 F.2d at 459-464; *Woods*, v. *Barnett Bank* 765 F.2d 1004, 1009-1010 (11th Cir. 1985); *Woodward*, 522 F.2d at 97, 100.

[36] The recklessness standard is nonetheless more restrained in its flexibility than is the "sliding scale" approach. Recklessness, for example, must take current standards of conduct applicable to the defendant's profession or position. The "sliding scale" approach has no similar reference to provide guidance.

[37] Petitioner argues (Br. 43-44) that this Court should adopt the Seventh Circuit's approach (see note 16, *supra*). Even the authority petitioner cites (Br. 38, 40) acknowledges, however, that that court has effectively abolished Rule 10b-5 aiding-and-abetting liability, in a

The AICPA and SIA argue that a recklessness standard is arbitrary and virtually indistinguishable from negligence. SIA Br. 22-26; AICPA Br. 27-28. But the primary authority cited for that proposition in fact disagrees with their view that the recklessness standard should be abandoned, concluding instead that it should satisfy Rule 10b-5's scienter requirement and that its rejection would mark a radical departure from settled common law. Johnson, *supra*, 59 U. Cin. L. Rev. at 695-696, 705-706, 710. For the most part, amici's criticism is directed not to the prevailing *Sundstrand* standard of recklessness (see note 17, *supra*), but rather to standards never used, or now abandoned, in Rule 10b-5 cases.[38] Nor has the Commission criticized the *Sundstrand* standard, properly construed, as being unworkable or indistinguishable from negligence.[39] Compare SIA Br. 23.

In sum, the scienter standard for aiding and abetting liability under Rule 10b-5 should be neither so low that liability exposure is excessive, nor so high that unlawful activity will escape deterrence and remediation. The recklessness standard avoids both liability for good faith or merely negligent conduct, and the undue weakening of

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striking departure from the consensus among the other courts of appeals. Feldman, *The Breakdown of Securities Fraud Aiding and Abetting Liability: Can A Uniform Standard Be Resurrected?*, 19 Sec. Reg. L.J. 45, 59-64, 66-67, 69, 71 (1990).

[38] *Smith* v. *Wade*, 461 U.S. 30 (1983), from which the SIA quotes only the dissent (SIA Br. 22), involved neither fraud nor securities. Moreover, the majority there was "*not* persuaded that a recklessness standard is too vague to be fair or useful." 461 U.S. at 49 (emphasis added).

[39] The Commission has taken the position that recklessness should be defined as a "conscious indifference to the truth." See *Hollinger* v. *Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990), cert. denied, 499 U.S. 976 (1991), SEC Br. Re Rehearing 13-14. That definition, however, is derived from common law deceit and fraudulent misrepresentation—not, as the SIA erroneously suggests (SIA Br. 24), from concepts of negligence.

the securities laws that would result from insistence on often elusive proof of conscious intent.

CONCLUSION

The judgment of the court of appeals should be affirmed.
Respectfully submitted.

DREW S. DAYS, III
Solicitor General

EDWIN S. KNEEDLER
Deputy Solicitor General

EDWARD C. DUMONT
Assistant to the Solicitor General

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

BRIAN D. BELLARDO
Assistant General Counsel

BRIAN F. MCNALLY
Senior Litigation Counsel

DIANE WHITE
WILLIAM JOHNSON
Attorneys
Securities and Exchange Commission

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